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NOTE TO: Bob Gates

FROM : 

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Bob

I thought you might be interested in this letter that I received yesterday from Leo Cherne. I found the whole discussion on East and West Germany particularly fascinating. In my gut, I think Leo is really on to something. At a minimum, it is something you might want to think about while mulling over this year's research plan. I suspect that one possible way to tackle such an issue would be a report that basically lays out what the trade, and political, and social linkages are between East and West Germany. At that point, the analyst could lean forward and explore a concept of unification and what it would mean for the Western Alliance. Such a piece could also pick up on some of the issues that were at least partially raised on p. 10 of the 26 July NID. In an article on East and West Germany, dealing with new credits that were being approved, we were told as part of the "facts" that "the East Germans -- citing Soviet suspicions -- were resisting a package deal". Needless to say, a reunification of Germany would not only directly affect our position in Western Europe, but also that of the Soviet Union.

STAT

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DCI  
EXEC  
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July 19, 1984

STAT

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Dear Rick:

We have been out of touch with each other for some time, but I want to tell you what I have already conveyed to the DCI -- that I think you and your colleagues are continuing to do both an indispensable and a good job on the LDC debts. I was especially impressed with the June 29 Weekly. There is no question in my mind that we have entered an altogether new phase. Greenspan shares my conviction, as clearly do your reports.

On another subject, I recently spent several days at an annual Austrian trilateral conference which dealt with a number of outstanding thorny economic and political issues. There was a good representation of Japanese, Western European and several of us from the United States. I was particularly delighted that I was asked to participate in a morning's discussion devoted entirely to structural changes in the industrial economies and what it is that can be done about them. I did not address myself (nor did anyone else) to the really important question of what may happen as a result of the severe difficulties these structural changes have produced, including problems within the Western Alliance.

I believe for example that a long standing, but on the whole well suppressed desire among Germans (East and West) for increasing de facto unification, is being given added momentum by the economic pressures which are closely related to the irreversible structural changes.

There are, of course, other factors which play a large role in any such change of German relationships, but as in the case of the LDC debts, it has been my conviction that economic pressures, no matter how real or great, do not by themselves produce political military or social upheavals. I believe that

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history, culture and politics play the fermenting role, with economics adding the missing and sometimes decisive element which produces a heady brew. In any event, while I may have missed an occasional item or report, it is my sense that "Global Issues" has not yet tackled this business of structural change and the potential for serious disruptive policy problems with which we will be confronted.

My formal remarks at the Austrian meeting were limited to ten minutes. I am enclosing a copy of those remarks. You will notice that I do not allude to the potential of which I have just written. I found it interesting that no other speaker among the Japanese, Western Europeans or Americans present alluded to such possibilities with the exception of the constantly mentioned pressures towards increased protectionism which all inveigh against while proceeding down that road.

When we next see each other perhaps we can exchange some thoughts about what it is that we ought to be looking at with greater intensity.

Warm regards.

Sincerely,

Leo Cherne

LC/cl

DIALOGUE CONGRESS WESTERN EUROPE - USA - JAPAN

July 7 to July 13, 1984

Alpbach/Tyrol

ECONOMIC FORUM: Round Table Two

Date: Tuesday, July 10, 1984, morning

Referee: Dr. Leo CHERNE, Executive Director, The Research Institute  
of America, Inc., New York, NY

Subject: "Structural Changes in the Industrial Nations and in the  
Relationship with the LDCs"

The structural changes - and what can be done

I identify the profound structural exchanges we are each experiencing in different degree, - I identify them more widely than is generally done.

I believe the first step to management of the problems they produce requires us to know how wide and pervasive these changes are.

I urge that the following changes are profound and largely irreversible

- 1) The growth of the extent of labor efficient high technologies in the industrial economies
- 2) The decline of labor intensive basic industries, largely manufacturing, in the industrial economies
- 3) The growth of skilled and unskilled service sectors in increasingly information societies
- 4) The growth of labor intensive manufacture in the newly industrial countries - coupled with labor intensive aspects of high technology assembly of components in the LDCs.
- 5) The vast transfer of industrial economies' wealth in the form of more than 800 billion dollars of loans to the LDCs. - Loans which cannot readily repaid - and will be serviced with difficulty.
- 6) Highly efficient, heavily subsidized agriculture in the US, Canada, Australia and Western Europe. Limited unsubsidized competition exists and is declining.
- 7) The profound change toward the interdependence of our economies - with moderate and reluctant change in our competitive attitudes toward each other.
- 8) The targeting by particular nations of certain advanced industries with a view to their domination of the international markets in those areas - a strategy which relies on government encouragement, joint Research and Development and assured financing.

Expedients which cannot be used without damage.

1. National efforts to protect inefficient industries, We will injure each other, impede the growth of world trade, merely delay the demise of inefficient industry - while making debt repayment all but impossible for the LDC debtors who enjoy comparative advantage in those labor intensive industrial areas.

levels in industries which are dependent on lower costs if they are to compete freely.

What we must do

- There must be substantial growth in adequately financed joint research and development both for the advancement of high technology and the modernization and automation of basic labor intensive industry.
- We must reeducate and retrain, or carry as a social cost, those who have been displaced.
- We are entering a less labor intensive economic era. Our conception of an appropriate work-week and adequate compensation must be altered.
- Each of our countries, in different degree, must make substantial changes in our education. This must aim particularly at upgrading our engineering skills, professionalizing manufacture, and creating the skills for an information age.
- We must maximize imports from the indebted LDCs - and credits to facilitate their purchases of our goods and services.
- Our approach to the servicing and repayment of the LDC debts must be altered to permit repayment in a manner which does not risk social and political convulsions and which does not severely contract their essential imports. We have passed a new threshold in this crisis of debt. The methods which worked well previously will not do for the future.
- We must courageously review the adequacy of the international institutions, the IMF, the World Bank, the BIS and other related agencies. They are not now adequate to carry their new burdens so essential to lubricate trade, facilitate the servicing and repayment of debt, assure a viable international financial system while requiring reasonable standards of participation by the industrial nations and non-punitive reforms by the less-developed nations. Above all these mechanisms must be adequately financed by the industrial nations and solvent oil-producing nations.
- Interest rates must come down, the value of the dollar reduced and the yen valued more realistically and in a manner conducive to increased two-way trade. Otherwise we risk the contraction

while risking the default of the LDC debts.

- Pioneering research and action must be aimed at new job formation in productive employment. This is particularly essential in Western Europe.

I'll be presumptuous and suggest that the European Community which has just solved its most chronic crisis - has nevertheless not yet found its soul. Something of "Jean Monnet's vision may be found if the "grocer's quarrels" are replaced by a heroic undertaking which seeks the answers to the structural dilemmas which plague us all.

Finally, I would like to share the hope and belief of our co-chairman Secretary Lionel Olmer that the new high technology threshold we have crossed, the new age of information we are all in, not only presents us with severe structural dislocations but will usher in new opportunities and new growth. Much that we now do will be changed and made more humane in the process. A new better époque can provide the growth which is indispensable for both the industrial and less-developed world.